ABNORMAL FEATURES OF AMERICAN BANKING

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Somebody once said to a celebrated English statesman, renowned for his clear perceptions of all economic subjects, "I suppose you understand all about the currency"—to which the reply was, "No, indeed I do not, but I believe there *are* people who do." Most of us are willing to admit that the currency is a complicated mystery. We may feel sure that we can trace the effect on the general financial situation of this or that particular factor, but we have to confess that we cannot balance the effect of all of the factors and state clearly, even after a panic, what has caused the disturbance and what we must guard against in future. But when we consider the currency and banking system of the United States, and remember what we have experienced in the panics of 1873, 1890, 1893 and 1907, we need not hesitate to admit that something is radically wrong, whether we can agree either as to the disease or as to the remedy. I have ventured by my title to suggest that there are abnormal features in United States banking, and this presumes that banking can be reduced to norms, and that aberrations therefrom can be demonstrated as such. I am not sure, however, that many clear principles in banking can be set out which are applicable everywhere. As a rule the banking and currency of a country have been intercepted in their natural development by the effect of war or by unwise creation of public debt, and, unfortunately, some-

times by the mere ignorance of legislators. When the natural trend of the banking of any country has been thus thwarted, time usually brings about, either by direct reform or by artificial compromises, such adjustments as are necessary to make the banking system reasonably useful to the country which it is supposed to serve.

In naming the prominent causes of deflection I placed ignorance last, but perhaps it should be placed first. As the great English statesman hinted, few understand the currency, and the country which in its constructive period possessed among its citizens a genius who among his other great deeds as soldier and statesman was determined to restore the disordered finances of his country and to set in the right path for the future the great industrial agency of banking, was unusually fortunate. Such a country was the United States at the close of the eighteenth century, and such a citizen was Alexander Hamilton. He doubtless knew little about currency and banking when he began, and we can almost see his mind turning, in the weltering confusion of the time, from one expedient to another in order to find a course which was sound financially and at the same time suited to the poverty of a country possessing a depreciated currency and no capital with which to create banks. He had about him the two usual types of advisers—those who were willing to try any course of reckless folly in order to escape from the present evils; and those who, while bewailing the evils, were unwilling to depart from the narrowest course of safety. This second class we have always with us—men only too ready to criticize, to point out dangers they are too timid to face, but never ready themselves to suggest a remedy for the evils to be dealt with. There were happily in those early days a few men of courage, sanity and intelligence in finance besides Hamilton, such as Morris, Gallatin and others, but the man of distinctly constructive ability was Hamilton. It does not seem to be material that some of his views regarding finance have been shown by time to be unsound, or that he was trying not so much to discover the abstract principles of banking as to mend the broken fortunes

of both state and individual by trying to establish banking and public and private credit on a sounder basis. Unfortunately—very unfortunately in my opinion—there was a line of political cleavage of vast importance, which influenced profoundly the discussion of banking then, and which still remains the fundamental difficulty in the path of reform. Hamilton strove with all his might for everything which would make a strong central power, he being unable to conceive how a great nation could otherwise be created. The extent to which the thirteen units of government then joining in the United States should retain or give up their powers of government was a matter of compromise, but, I fancy, Hamilton would have approved of the plan we adopted in Canada in 1867—that is, to give the Provinces certain powers and reserve all other phases of sovereignty for the Federal Government. Among the powers possessed only by the Federal Government in Canada is that relating to banking; but in the nascent United States the thirteen States already possessed many small banks and besides this the fear of the concentration of power of any kind was widespread. Apart from these obstructions to a sound course, the country did not possess the capital with which to create a great industrial bank. The fear of partial ownership, including the control of the stock, by the state, existed among many, very rightly I think; and the fear that a great bank of which the control was owned privately might fall under the power of foreigners, perhaps of England, was certainly natural enough at that time. In the midst of such difficulties the first Bank of the United States was founded, but in a few years, and while, as we can now plainly see, it was doing its allotted work very well indeed, it was strangled by those who favoured the small banks. Almost immediately the second Bank of the United States followed, only to meet a similar fate at the hands of Jackson. Thus for the second time a system of banking which might have made the country strong to meet financial emergencies, which tended already to make the various scattered parts of the country cohere in commercial matters, which was rapidly creating credit in Europe, and which with

all the inevitable faults of youth was performing the functions claimed for it remarkably well, was destroyed in favour of an incoherent system of individual state banks.

I am a foreigner, but as five of the establishments included in the bank of which I am President are situated in cities of the United States, I hope you will not regard me as a foreigner for the moment. There are very few banks in the whole country who have a larger interest in the soundness of your banking and in your freedom from panics than my own bank. Remembering my peculiar position, I am particularly desirous not to wound the susceptibilities of any of my hearers, but I hope it is safe to say that Alexander Hamilton was clearly the leading intellect in that wonderful group of men who framed the constitution. At a time when few men could withstand the onrush of new ideas, largely visionary and false, which accompanied the French Revolution, Hamilton was unshaken in his clear vision as to the future of his country, and few will deny that where you followed his advice you did well, and where you opposed it you did not always act wisely. It may be argued that neither of the two Banks of the United States were so admirable in their careers that we need sigh over their removal, but we can only judge them by comparison with the smaller banks of the same period. In your colonial and revolutionary times you had a curiously full and varied experience in banking and currency. Fiat money, depreciated coinage, currency based on land, clamour by debtors for cheaper money with which to pay debts, were all amply experienced. In the following period, contemporaneously with the first and second Banks of the United States, you passed through a time largely of mania in banking; a time when history was recording for this country such fundamental facts as that banks cannot establish a capital fund merely upon the promissory notes of shareholders; cannot put bank-notes into circulation even by the expedient of sending them far from home before issuing them, without considering how they are to be redeemed; cannot lend money on land, or lock it up in other ways, and also have it again when the bank's debts, exigible on demand,

fall to be paid. Indeed it was a time when every vagary in unsound banking was being tried. But Hamilton, from some of these experiences and from European history, planned for you a banking system which contained much of what is good in the successful systems of the world. You would not, however, have his system, but preferred to repeat in each new district, from east to south and west, wherever debt and ignorance combined to create banking and currency, the same errors which make such startling history in the early part of the nineteenth century. Is it not time for us to put aside that silly vanity to which democracies are inclined—that it is better to try our own experiments and to ignore history? Unfortunately the apparently brand-new experiments we are willing to try have usually occurred to others in the past, if we had but patience to discover the fact.

I may as well at this point admit that I have nothing new to say. I am merely trying to put facts and arguments made many years ago into a new form. We are dealing with a case where the patient has immediately after each serious illness exclaimed: "What shall I do to be saved?" has repeatedly been given good advice by the experts of his own country, and has never yet in any particular acted in accordance with such advice. What seems to be necessary is not so much to suggest means of reform, as to induce the patient to believe firmly, once and for all, that if he persistently neglects all remedial measures the next attack may leave him in a state past all aid. Any purpose I have in reading this paper will be amply served if I can for one brief moment lay emphasis upon the disagreeable fact that while reform in the banking and currency systems of the United States is absolutely necessary, there is no probability whatever that any substantial reform will take place at the moment.

The profound line of cleavage which made it so difficult to create the first Bank of the United States, and which destroyed it and its successor, still exists. It lies between those who favour a system of banking good for the nation as a whole, as opposed to a system of banking which may be right or wrong for the great number of units engaged in the business

of banking, but which is clearly not right for the nation as a whole.

It is not possible in the short time at my disposal to review all of the features in the banking of the United States in which the obstacle to reform lies mainly or altogether in the existence of numerous small banks, but with your permission I shall take up a few of the leading features.

RESERVES.

Most prominently I would place the so-called fixed reserves—the attempt by law to fix the minimum percentage of cash to be held by each bank against its liabilities.

The real reserve requirements of any particular bank differ from those of other banks in accordance with the nature of its obligations as compared with theirs. It is conceivable that the ideal point at which cash reserves should be kept would be different in the case of any ten or twenty banks which you might select for comparison even in the same city or community. The bank which acts mainly as a banker for other banks needs very large reserves indeed. A bank in the same city doing mainly the business of manufacturers, merchants, exporters, etc., will need altogether smaller reserves, and a bank gathering the savings of a quiet country community needs much less again. The law attempts to recognize these facts, but is evidently unable to do so except in a most imperfect manner. Clearly each bank, if it could be trusted to have sufficient intelligence, should be the judge of the reserves it should keep, and it seems safe to say that if you had continued to create large banks with branches, instead of thousands of small banks, the attempt to provide wisdom by law would never have been made. You would doubtless have done as all other nations have done, and not have been an exception to so general a rule.

If the wrong done only resulted in causing some banks to keep more reserves than they actually required, little would need to be said ; but, as has been shown, the law can be so worked as to provide reserves quite too small, and experience shows that banks as a rule choose to keep reserves larger than

the law requires. The defect in the law, however, is that by arbitrarily fixing the minimum reserves which must be always in hand, it practically forbids the use of the reserves for the very purpose for which they have been created. The law undertakes to supply that wisdom which it presumes the thousands of bankers do not all possess, and to lay by for them against the rainy day the provision which it presumes they would not be prudent enough to make. But who is to supply the wisdom demanded by such authorities as Walter Bagehot, who says that in a panic the sound banker should lend to the bottom of his box? In times of peace the wise prepare for war, but when war comes the army is flung into the field, not still held in reserve. The law, however, having forced the sequestration of so much cash and cash resources against the day of trouble, provides no means by which, either under its own wise and paternal direction or at the discretion of the bankers unaided by the wisdom of the law, the cash thus provided may be used to avert disaster.

I do not wish to be understood as claiming that the present law should be repealed and the thousands of individual banks be left to do as they like. I presume it is true that they cannot be trusted, and that because of the folly which destroyed a more natural system of banking you have condemned yourselves to submit to a paternalism which fixes your cash reserves for you. But I urge as one of the great evidences of the unnaturalness of your system of individual banks the fact that they cannot be trusted to take care of their own reserves, and that no law has been devised which will act the part of Providence for them. I do not maintain that where the banks are larger relatively to the country, as in Canada, they are always wise enough to keep sufficient reserves. It is, as we know, a subject much discussed in many countries, and it would be well indeed if banks could in some way be forced to keep larger reserves, provided there be no interference with the use of these reserves when the hour of danger arrives.

Everybody admits the mischief created in the United States from the inability to use legally the reserves for the

very purpose for which they are held, and I do not remember that anyone has suggested a better remedy than that which takes place in every panic, viz., the breaking of the law by simply not maintaining the reserves. But through the press the public is kept keenly aware as to the exact point in the New York reserves below which the use of them will be illegal, and thus the panic is increased by the very attempt to get at the cash necessary to allay it, while under any ordinary system the panic could probably be averted altogether by a wise use of the cash in hand, instead of being allowed to reach a stage where it can only be stopped by almost superhuman efforts after it has run part of its course of ruin and disaster.

I think that the statement on the opposite page will show that almost every panic since the war could have been prevented or arrested early in its course by the natural use of only a reasonable part of the actual cash in hand.

CLEARING HOUSE CERTIFICATES AND RE-DISCOUNTS.

In order to avert panics, and also in order to avert the failure of an individual bank with sound assets, something more may be necessary than the unrestrained use of the cash and quick assets in hand. The ability to re-discount should exist somewhere within reach. The great banks of a country should manage so as not to require such aid, but small banks in most countries require it from time to time, and not merely at the moment of a panic. Under ordinary conditions a bank in the United States requiring to re-discount some of its paper can do so, but if there is any financial strain all bankers, big and little, begin to button up their pockets and re-discounts soon become nearly impossible. Indeed, instead of the banks in the great financial centres, where alone the power to aid could be expected to exist, being able to help their country friends, some of them are soon unable to get along without aid from other members of their own city clearing-house. But there are almost no banks of sufficient national importance to feel the necessity of aiding directly their weaker brethren, whether it is convenient to do

NEW YORK CLEARING HOUSE.

	1873	1884	1890	1893	1907
1. Cash reserves at beginning of panic......	$53,152,500	$86,911,000	$99,773,100	$110,410,900	$267,610,500
2. Surplus over legal requirement..........	3,642,475	4,455,450	701,975	8,776,800	11,182,650
3. Reserves at lowest point as compared with legal requirement..............	19,669,000	67,536,700	91,801,400	76,505,500	215,851,100
4. Deficiency in reserves at this point......	18,893,075	6,607,125	*2,429,650	16,545,375	54,103,600
5. Date of first issue of Clearing House Certificates........................	Sept. 22	May 15	Nov. 12	June 21	Oct. 26
6. Date of maximum issue of Clearing House Certificates......................	Nov. 20	June 6	Dec. 22	Sept. 6	Jan. 30, 1908
7. Date when last Clearing House Certificate was retired......................	Jan. 14, 1874	Sept. 23, 1886	Feb. 7, 1891	Nov. 1, 1893	Mar. 28, 1908
8. Maximum amount issued..............	$26,565,000	$24,915,000	$16,645,000	$41,490,000	$101,060,000

* In 1890 the reserve fluctuated considerably from the first of July to the end of the year, and was below the legal requirement frequently before the issue of Loan Certificates. On Sept. 13th the deficit was $3,306,925, and two weeks later the excess was $14,075,400.

so or not, and thus the clearing-house certificate came into use. It is not only a splendid tribute to the genius of the American people for organization, but so long as its use is between banks alone it is a perfectly natural and a most effective plan for allaying a panic that has once been created. It could also be made an instrument in connection with a proper use of reserves, to largely avert panics, if only some wise autocrat could be entrusted to decide when clearing-house certificates should be issued, but as to the moment of necessity there is never likely to be unanimity of opinion so long as the decision depends on the judgment of several bankers. And therefore the illegal use of the cash reserves and the issue of clearing-house certificates must always come too late to prevent the panic. They may alleviate and cure, but they are not available to prevent. Still they are such a natural and efficient means of making the banks who have abundant reserves help those who have not, that we may expect to see clearing-house certificates or something closely akin to them in other countries where there is no great state bank to whom smaller banks may go with some show of right.

Until the latest panic these loan certificates were only issued in the largest money centres, but on this occasion they were issued by fifty-one clearing-houses, and doubtless in the course of future panics they will become practically available to every bank. The wide extension of their use, however, raises a new question. Used in the real money centres and issued only in large blocks between banks they remain what they were intended to be, mere loan obligations assisting banks to build up their reserves, and also enabling them to make additional loans to customers who but for such aid might fail. But the extension of their use to numerous cities and towns where actual cash supplies are nearly exhausted, and the issue of these loan certificates in small denominations to the general public as currency, in open defiance of law, while creditable to the ingenuity and audacity of the American people, are new features of an alarming character. There are dangerous expedients we praise ourselves for resorting to when heroic action is necessary for the general

safety, but which are little better than crimes if they are repeated. An able banker* has referred to clearing-house certificates as an "emergency circulation," and as an "asset currency" that even he would approve of. I think much mischief will arise if these loan certificates are ever generally regarded as anything other than what they were originally—a species of re-discounts between banks. Currency, to be such, should be available between the banks and the people, and should surely be legal whether it is wisely issued or not.

But before leaving the subject of clearing-house certificates let us consider how their use, and volume, and abuse, are affected by the existence of thousands of individual banks instead of a comparatively few large banks with branches. Whether we have one system or the other the actual cash will accumulate largely in the few great monetary centres. In the case of individual country banks the cash not needed at home goes to their reserve agents, while in the branch system the series of branches of any one bank are practically one clearing-house with a settled tendency to accumulate actual cash beyond the mere necessities of the till in the money centres. While retained in these centres, the cash, except to the extent of the reserves, will be employed in some manner so as to earn interest. Now, the extent of the reserves necessary on the one hand and the extent to which the surplus funds may be lent on the other is a matter of experience in both systems, but the experience is very different indeed. If we take as examples a bank in a reserve city with one hundred banks as correspondents, and a single bank in another country with one hundred branches, we can readily see the difference. In times of strain the one hundred branch managers do not ask for cash from the head office unless it is actually needed; on the contrary, the moment contraction of loans begins they are a source of strength to the head office. The credit affected and the thing to be managed is one organism. Within this organism fear of each other by its component parts will not enter, and whatever courage its executive

*William A. Nash: "Clearing-House Certificates and the Need for a Central Bank."—*Annals Am. Acad. Pol. and Soc. Science*, March, 1908.

possesses will actuate every part of the organism. But in the other case there are a hundred organisms and no cohesion, except that, the skies being bright, all will cohere somewhat, not with each other, but with the one bank in the reserve city. And if the skies are overcast we have a hundred utterly selfish organisms all concluding that their balance with the bank in the reserve city would be better in their own vaults; in any event they would sleep better if it were there. And so we have the extraordinary spectacle which accompanies every panic in the United States of each particular one of the thousands of banks trying to stand alone, except to the extent that the clearing-house certificates have made them cohere. Almost every bank wishes to withdraw its balance with other banks, and as this is an absolute impossibility, the panic reaches its crisis, currency payments are suspended, all currency is hoarded and passes to a really large premium, and the ingenious expedients to which we have referred, whether legal or not, are made use of with that general concurrence by the people and the banks which only exists in the face of a great national danger. The great national danger is that the panic may cause national ruin. But what is a panic? A widespread fear without cause. In most countries financial panic is caused by fear on the part of those who are not a part of the national finance—who are not bankers and such. But in the United States, whoever may start the panic, those who accentuate it most are the thousands of individual banks by their distrust of each other. We speak indignantly about the private individual who draws his deposit in currency and hoards it. But in time of panic the most active agency in drawing out currency and hoarding it, is the country bank. And it is not the fear of the failure of banks, but the fear of the disappearance of currency, which aggravates panics and brings about disaster and terrible reduction in values. To sum it up, it would appear that the same elements which in the United States cause panics of the most ruinous character would not be apt to cause panic at all in better regulated countries. In such other countries, firstly, the reserved cash would be instantly available; secondly, the banks would not be

likely to fear one another, but would cohere in meeting any panicky feeling on the part of the public; thirdly, the power of re-discounting or of issuing clearing-house certificates would need to be used to but a small degree if only the demands of the public had to be met and not the demands of thousands of individual banks; fourthly, with these things assured and a reasonably flexible currency, no stoppage of currency payments would be likely to arise.

THE TREASURY SYSTEM.

Flexibility in the use of cash reserves, in obtaining rediscounts, in distributing Treasury balances, and in the issue of bank currency, still seem the main features to be discussed. I have little to add to what was said years ago regarding the Treasury. Then it needed some courage to say it, but now even a Comptroller of the Treasury, writing early in 1908, does not hesitate to sum up the whole evil in the following frank statement:* "But look at the situation. The United States Government has collected from its people $245,000,000 surplus, above its necessary expenditures, and in order to restore this money to circulation and *repair the damage done to business by its withdrawal*, has had to deposit $222,000,000 with the national banks; and when the supply of Government Bonds gave out, has had to accept various other bonds as security." And in the same connection he says of Secretaries Gage, Shaw and Cortelyou, that "they are all entitled to the highest praise and commendation for what they have done to make the best of bad situations, with antiquated, complicated and cumbersome facilities, often little better than mere make-shifts." But why not face the fact that the present Treasury system was created because of the destruction of the system of large banks in favor of the system of small banks, and would never have existed otherwise? Under the present system there is no one bank and no series of banks to whom the United States people, as they are represented by the Federal Government, can entrust their balances without

*Wm. Barrett Ridgely: "An Elastic Credit Currency as a Preventative of Panics."—*Annals Am. Acad. Pol. and Soc. Science*, March, 1908.

very complicated arrangements, including the deposit of security. Whatever may be the remedy, in the meantime we must add the Treasury system to that list of abnormal features which this country has to bear because of its thousands of individual banks.

BANK-NOTE ISSUES.

The fourth main element in banking in which flexibility is necessary is bank-note issues. This has become a hackneyed subject during the last fifteen years or more, but indeed it has never been long out of the arena of discussion regarding banking in this country since early colonial days. The currency, as we have said, is a complicated mystery, and for that reason it has a strong hold upon the imagination of the average man. But in addressing an audience of bankers it might be well to avoid the broader definition of money, and to try and separate the credit instruments usually issued by banks and passing as money, from metallic money, paper money representing metallic money, and paper money based on the debt of a government. The species and quantities of money current in the United States on 1st August were approximately as follows:—

Gold Coin and Bullion	$811,541,020
Silver Dollars	79,303,982
Subsidiary Silver	147,005,385
Gold Certificates	818,758,869
Silver Certificates	484,054,000
United States Notes	346,681,016
Treasury Notes of 1890	4,903,000
National Bank Notes	692,088,991
	$3,384,336,263

The figures given above do not include an equivalent amount of gold coin and bullion, and silver dollars held in the U.S. Treasury as a redemption fund for the gold and silver certificates outstanding.—(Taken from *The Commercial and Financial Chronicle*, New York.)

From this it is apparent that in the United States there is no currency of the kind usually known as bank-note issues, the notes issued by national banks and guaranteed by the Government being a species of money based on the debt of a

Government. There were bank-note issues before the war, and, as we know, they were retired for arbitrary reasons connected with the finances of the Government, and not for the purpose of improving the system of banking. We also know that while the national bank-notes which took their place possess good qualities not possessed by the old state-bank issues, they also carry with them the grave defect of rigidity which accompanies nearly all Government note issues. Under the new "Currency Association Law," permitting an emergency circulation, bank-issues are to be permitted, but under restrictions which practically amount to an admission that the issuing of credit notes is too dangerous a franchise to be granted to a bank under ordinary circumstances. Indeed, the whole machinery for these emergency issues is so difficult that the Act may quite fail in its purpose. In Canada at about the same time we also passed an Act permitting an emergency circulation. Our Act contains 967 words, while that part of your Act which deals with emergency circulation contains 3730 words. This is not a very reliable manner in which to compare the respective value of two Acts of legislation, but in this case it may be said that the difference in words fairly represents the difference in ease with which the additional franchise of an emergency circulation may be given to a few large banks with branches as compared with thousands of individual banks.

Returning to the ordinary currency, we find that with the exception of the gold coin and paper money directly based on gold coin, all of the vast remainder is currency created for some reason not concerned with the benefit of the business of banking, or, what should be the same thing, of trade generally. We see fiat money rendered necessary by the war but not since funded or redeemed; depreciated silver, or its paper representative, kept at a gold equivalent by the good credit of the United States, a sort of half metallic—half fiat money; and bank-issues, so-called, which are merely indirect evidences of Government debt Now, if these species of currency provide all that is necessary in the interest of trade, no one, in the interest of the banks alone, has the right to

complain. But is it possible that under modern credit conditions the peculiar functions which in most countries are performed by the credit-notes of a bank should be performed by a mass of currency which if not constant in volume is so nearly so that its non-use at once represents to any holder except the Treasury the loss of so much interest? Let us consider once more the functions of the credit-notes of a bank. There are still people who imagine that a natural and quite desirable condition would be one where, whenever money is given as the purchase price of a commodity, that money should either be gold or a silver equivalent, or, if paper is used, that the paper should be actually represented by an equivalent amount of gold or silver practically ear-marked for the purpose. As we know, there is not sufficient coin in the world to make this even remotely possible. As we also know, the trade of this country is rendered possible only by cheques, drafts, clearing-houses, paper money of the various kinds we have referred to, and various other substitutes for money which in the main merely shift the credits and debits between different individuals and institutions. We shall never return to the simpler conditions of the use of money which closely followed barter, and I presume we do not wish to. But if we do not this nation must manage somehow to achieve its large volume of trading, done so largely by credit instruments, in such a manner as to avoid panics and such violent changes in prices as cause widespread ruin. Let us be frank with one another and admit that you have been quite unable to do this. You have achieved the huge volume of trade; you have achieved the necessary transportation—most difficult of problems usually; but you apparently cannot manage the shifting of credits without panic. You constantly fall short of currency, and the fear of this accentuates the difficulty so much that sometimes those who have the power to do so lock all the currency up and leave the country without the necessary financial machinery with which to carry on business.

There are countries in the old world where the fluctuations in the volume of trade and in the price of commodities and

securities from one year to another, and from one part of the year to another, are not so violent as to require much elasticity in the currency. But in the United States, where the volume of trade and the price of commodities and securities vary largely from one period of contraction through a period of expansion to the next period of contraction, and from one year to another, and from one part of a year to another, and from day to day, there should be, in addition to the constantly varying total of chequ , drafts, and such credit instruments with which most of our trade is done, a species of credit-note issuable by banks which can be varied in total quantity in proportion as the total quantity of trade done with such instruments of credit varies. And there is the additional reason for such a credit-note that whenever, because of panic or any form of distrust, the ordinary currency is hoarded or additional cash is being held by banks as reserves, some legal credit currency becomes more than ever necessary. No one at this late day will advocate the issue of such a credit currency unless it is perfectly safe. I know the history of paper money in the United States from colonial times down to date well enough to know that in suggesting credit paper money the long and dismal history of disastrous experiment in this country comes up as a sort of bogey. I was engaged in business early enough to remember the last of the state-bank issues which in the case of solvent banks passed at a discount if geographically distant, and at a larger discount if the bank laws of the particular State in which the note was issued were supposed to favor loose habits or undue risk in banking. But it is to the last degree unfair to judge any of the recent suggestions for an asset currency by ante bellum experiences. A currency issued to the extent of the paid-up capital or less, as you have generally proposed; secured as your National bank-notes now are, by a first lien on the assets of the bank including the double liability but not by anything specially deposited or ear-marked; further secured by an insurance fund; and bearing a fair rate of interest if not paid by the liquidator immediately after suspension, is perfectly safe in any country where daily

redemption can and will surely be effected. The whole difficulty in carrying out such a plan in this country lies in the fact that you have become used to a system which requires practically no redemption, and with so many thousands of banks you do not quite know how, or you are not quite willing to take the trouble to establish the complicated machinery necessary to effect such daily redemption.

Th[illegible] he issues proposed are credit-notes, while National bank-notes are not, and that they must be subjected to actual daily redemption, while National bank-notes need not, should never be lost sight of for a moment. One of the greatest elements of safety in such issues lies in the fact that having performed the credit service required they will immediately come back for redemption. But some of you will ask how with thousands of banks can you prevent a bank in Kansas arranging with a bank in Oregon to circulate each other's notes, so that the volume kept out would be increased by the geographical distance on the one hand, while the difficulty and expense of returning for redemption would be made unbearable on the other? Clearly by organization you could prevent this, but it is rendered so troublesome by the many thousands of banks that you doubtless will not do so. But again it seems that the obstacle to flexibility in your currency also lies in your thousands of individual banks.

CENTRAL BANK.

There are practically only two directions in which those who desire reform are looking for aid. These may be summarized as follows:—

(*a*). Plans differing in detail, but looking to the creation of a credit-note system of bank currency based upon the assets, somewhat similar to that in use in Canada, although much more restricted in the extent of the powers or franchise to be granted.

(*b*). Plans differing in detail, but looking to the creation of one central bank, which alone is to have the franchise of issuing credit-notes.

In the most comprehensive form which I nave seen, the proposal to form a central bank sets out the following features:—*

1. A capital of say $100,000,000 to be invested in Government Bonds.

2. The shareholders to be National banks, and possibly, also, State banks.

3. To issue its notes, say for $300,000,000, in exchange for gold provided by the banks who become shareholders.

4. To be authorized to issue additional notes up to say $600,000,000, provided a gold reserve of at least 33⅓ per cent. of the whole issue is maintained.

5. The central bank to use its powers of lending merely by re-discounting for or lending to the other banks of the country.

6. The shareholders to be represented by a board of directors elected by territorial districts.

7. The Government also to be represented in the directorate by officers of the Treasury Department.

Among the merits claimed for such a central bank are the following:—

(*a*). It would remove the nuisance of the Treasury, and cause the balances of the Federal Government to be available as lending capital when necessary.

(*b*). It would not, like the two banks of the United States be a rival to other banks, because the latter would be shareholders. This, however, would require that every bank created hereafter should have the same right to proportionate shares as those taking shares at the inception.

(*c*). It would probably prevent such a lack of currency at any one time as to cause panic.

(*d*). It would to some extent create that necessary cohesion among banks in time of trouble which is now almost absent.

(*e*). It would steady credit so much as to set the pace of confidence among the smaller banks.

(*f*). It is alleged that because of the territorial directorate, and notwithstanding the presence of Government officials on

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* Hon. George E. Roberts: "The Need of a Central Bank."—*Annals Am. Acad. Pol. and Soc. Science*, March, 1908

the board, there would be no reason to fear that politics might control the working of the bank.

Among the defects of such a system which have been or might be urged are the following:—

(*a*). The possible customers of the central bank would consist of eight or ten thousand banks,* who would also be the shareholders. It would be necessary to satisfy these customers that the favours of the central bank were distributed fairly, and especially fairly as to geographical sections of the country. This would make it necessary for the central bank to know the credit status of each bank and of each customer of each bank, or at least of those customers whose paper might be offered for re-discount or who might require a loan. It is quite true that the number of banks out of the eight or ten thousand requiring re-discounts or loans might be very small relatively, but that does not alter the quantity of knowledge necessary, as it would be impossible to tell in advance who might at any moment apply for such accommodation. And if for the soundest reason a re-discount or loan were refused, discontent would be apt to result. No central bank elsewhere in the world is called upon to perform such a task, and I fear it is impossible of satisfactory performance.

(*b*). It would also be absolutely necessary to keep the customers permanently convinced that no political influence could be used to favour one customer as compared with another, or one district as compared with another. Now, it might be quite possible to keep political influence out of the management of the bank, although surely no one can feel certain as to this, but can we believe that in a country where party strife is so keen, the customers of the bank and the people will remain continuously convinced of this fact?

(*c*). An argument against such a central bank, which perhaps will appeal more strongly to a Canadian than to an American banker, is that as the central bank may not have any customers except banks, it can do nothing to change the state of affairs now existing because of which a large borrower

*The total number of banks is larger than the figures here mentioned; there are probably fifteen or sixteen thousand banks including all classes.

may have either to keep a discount account with a great number of banks, or to sell his paper to sometimes as many as fifty or sixty banks, or even more, through the medium of a note-broker. This clumsy manner of borrowing not only prevents that close intimacy between a sound borrower and his banker which, lasting over a series of years, tends so much to create firmly cemented credit relations, but it undeniably has often caused perfectly solvent American merchants or manufacturers to fail—a thing which in other countries would be regarded as reflecting on the banks of such countries.

(*d*). Another argument which would appeal to Canadian banks and to all other bankers engaged in financing the export and import business of the United States, is that the central bank, having no customers except the banks of the United States, could do little to build up the foreign exchange business, which is still done mainly by bankers other than the National and State banks. Now that you own the Philippines and the Hawaiian Islands, now that your foreign trade is increasing so rapidly and, should your tariff be lowered, will increase much more on the import side, surely the need of great banks in the United States capable of establishing large banking connections with other countries, and capable of doing a large international business themselves, is obvious.

(*e*). When all this is said, however, there is little doubt but that a central bank, if wisely administered, would be an improvement upon the present conditions, but if the temper of your people will permit such a departure from your present system, there are surely better plans for the permanent reform of your banking. A recent writer, who is strongly opposed to centralization of power as opposed to "states rights," puts his main objection to a central bank in the following significant words:* "In my judgment our currency, like our other evils, is to be remedied by greater freedom and greater distribution of choice and discretion, rather than by a greater centralization or unequal distribution of power. It is a fair question to ask, therefore, whether conceding, as I do, that there is not

* George H. Earle, Jr.: "A Central Bank as a Menace to Liberty."—*Annals Am. Acad. Pol. and Soc. Science*, March, 1908.

sufficient elasticity of the currency, I can suggest no remedy, but would prefer present evils to those resulting from the creation of too centralized a power; and the answer, to my mind, is obvious. The true remedy must be found, not in placing our dependence upon the discretion of any one, but of every one,—that is, again, upon liberty, rather than upon power and restraint." Without regard to whether this is in the abstract a wise view or not, I think we must admit that it is distinctly the American view and those who have carefully read the history of early American banking will recognize that each attempt to depart from it has aroused most passionate opposition.

So far as my own opinion is concerned, I do not find that it has changed materially since I had the honour of addressing the New York State Bankers' Association in 1895. I felt doubtful then as to the probability of the necessary reform being acceptable to the existing bankers, and I am not much more hopeful now. But if the people are willing to create a central bank, with the monopoly of banking which would be involved, they should be much more willing to create a series of large banks which could perform every good feature of centralized banking, and still preserve that chief safeguard of the people in industrial matters, viz., competition. And even if the people and the bankers are not willing, I need not, I suppose, on that account hesitate to state what I happen to regard as a more reasonable solution than can be found in any other direction.

In order that reform may be permanent and effective the new species of bank should be able to create:

(1) A sound credit currency with effective daily redemption.

(2) A distribution of capital available for lending, so that it shall not be idle and congested in one locality and scarce or non-existent and proportionately dear in another.

(3) A condition where the gold and other cash reserves of the country may be made more effective and doubtless be minimized in quantity.

(4) Where in time of trouble the capital of the country may be mobile and capable of being centralized when necessary.

(5) Where there may be banks capable of doing the entire lending business of your merchants and manufacturers, except where these are unusually large, when they could be divided by arrangement between two or three banks.

(6) Where a great international banking business may be created and you may do justice to your over-sea possessions, to the great ports of export and import, to your mercantile marine, and to your position among the great nations of the earth.

This state of things can, I think, only be brought about by your permitting the creation of banks in the United States similar to the banks of other countries. As I have tried to show, the mere creation of one central bank will not change the defective character of the eight or ten thousand other banks. The suggestion I ventured to make in 1895*, and which I give below unaltered, was based upon the National Banking System and the ten per cent. tax on State bank issues being allowed to remain as they are, and the new powers to be added to those enjoyed by a National bank or to be enjoyed by banks under State or Federal charters as indicated below:

"Any bank with a paid-up capital of $1,000,000 or over, to be allowed to issue notes, say to the extent of 75 per cent. of the paid-up capital, secured only by being a prior lien on the assets of the bank, including the double liability of stockholders, and by an insurance fund of say five per cent., and to be free from the ten per cent. tax. Such banks to be allowed to establish branches within the State in which the head office is situated. If the franchise is granted by a State the Federal Government to approve of the regulations securing the note issues, and to hold the insurance fund. I do not enter upon the question of what the minimum paid-up capital should be in the case of banks desiring to avail of such bank issues but not to open branches. I hope, however, it might be practicable to make it as high as $500,000."†

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*B. E. Walker. Address New York State Bankers' Association, 1895.

† In saying that I hope it may be as high as $500,000 I do not wish to be misunderstood. Provided a scheme is established which will enforce actual daily redemption, there is no reason why banks with a smaller capital than $500,000 should not be allowed to avail themselves of the privilege of issuing asset currency.

"Any bank with a capital of say $5,000,000 or over, to have the same privileges as to note issues and to be allowed to establish branches throughout the United States limited, if thought necessary, to cities of national and not local importance. Such a franchise would, I suppose, be granted by the Federal Government. In view of all that has happened since the war, I presume it would not be too great a stretch of Federal power to grant such a franchise."

In the light of later experience I should think that banks having power to establish branches throughout the whole of the United States and its over-sea possessions should have a larger minimum capital than $5,000,000. This, of course, proposes asset-currency, and I am aware of the arguments which have been made against it. But no effective argument has been made other than the difficulty of applying it to thousands of relatively small banks, and effecting that daily redemption which is indispensable. That it can safely be applied to all individual banks with a capital of $500,000 and over, and to all banks with branches with a capital of $1,000,000 and over, I have no doubt whatever. That it is extremely desirable in this country if it can be made safe, I am quite certain.

But quite as important as the asset-currency, to my mind, is the branch system. If you make your laws so that it is merely permissive, surely the branch system will not come into being in an important degree unless it is right in principle. If it is right in principle, should the particular interests of ten thousand or more individual banks stand in the way of a great public good?

However frank I may have been I have not dared to strike such a high note of criticism as many of your own bankers, remembering that I am a foreigner, but if what I have said offends I beg you to forgive, and to believe that I have no ends to serve, and have spoken out of a full heart that which to me seems to be the thing I hope we are all seeking—the truth.

I thank you most heartily for your patience in listening to my rather lengthy paper.